No. 18831

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

ALEXANDER T. CHOHON,

Bankrupt.

ANSWERING BRIEF OF THE TRUSTEE.

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Comment on "Statement of the Case" in Appellee's Brief.

We cannot accept as a true statement of the facts or as a proper conclusion of law that after the two grant deeds were recorded, legal title to the home property has since remained vested in Title Insurance and Trust Company.

The transaction between the bankrupt and Title Insurance and Trust Company was a loan with security given by the execution of two grant deeds and a declaration of trust in the nature of a trust deed. Under the law of California, the bankrupt and his wife retained legal title in the real estate at all times.

ARGUMENT.

We have not argued the question of the exact nature of the bankrupt's title in our opening brief, except to say: That it is our contention that whatever the bankrupt's interest was in the home on the date of bankruptcy, it was such an interest that vested in the Trustee under the provisions of Section 70a(5) of the Bankruptcy Act when bankruptcy was filed.

That the interest of the bankrupt having vested in the Trustee at the time bankruptcy was filed, could not later be impressed with a valid homestead filed by the bankrupt regardless of whether the bankrupt held an equitable or legal interest. This contention is based upon *White v. Stump*, 266 U. S. 310, 45 S. Ct. 103.

Nature of Security Given by the Bankrupt Upon the Property in Question.

A question of law and fact arises as to whether or not the security transaction between the bankrupt and the Title Insurance and Trust Company constitutes a mortgage (See 33 Cal. Jur. 2d beginning at p. 437) or whether it is a deed of trust (See 33 Cal. Jur. 2d, beginning at p. 490), but in either event, where the grantor conveys the property for security purposes only, and retains possession and control of the land, as was done in this case, he also retains actual title to the land.

A GRANT DEED GIVEN TO SECURE A DEBT IS HELD TO BE A MORTGAGE, AND DOES NOT ACTUALLY CONVEY TITLE TO THE LAND.

33 Cal. Jur. 2d, p. 437, Paragraph 21, says in part:

> "It has long been recognized in this state that a deed absolute in form may be shown to have been intended as a mortgage, and, if it was intended as security for the payment of a debt or the performance of any other obligation, it will be held to be a mortgage. This principle, as laid down by the courts, is substantiated by a statute that provides, in effect, that every transfer of an interest in property made only as security for performance of another act is deemed a mortgage."

33 Cal. Jur. 2d, p. 440, Paragraph 24, says:

> "A conveyance of real property, though absolute in form, given as security for the payment of a note and unaccompanied by a change of possession, is in effect only a mortgage, and merely creates a lien in favor of the grantee. It does not actually convey title, *despite recitals to the contrary.* This is so whether the obligation the deed is given to secure is due to the grantee or to another." (Emphasis ours.)

And, see also *33 Cal. Jur. 2d, p. 442, Paragraph 26,* which says in part:

> "A court does not look to the form of an instrument, but to its real character as having been given for the purpose of securing indebtedness. Even where an agreement bears no visible earmarks of a mortgage, if it was actually entered

into for the purpose of security no form of words, however adroit, can estop a party to plead and prove that fact. If the transfer is made as security, *it is in equity a mortgage irrespective of the form in which made, no matter how expressly the parties may agree that it shall not be deemed a mortgage,* or regardless of how strong the language of the deed or any instrument accompanying it may be. *It is a matter of law, not of contract.*" (Emphasis ours.)

In *Stockel v. Elich*, 112 Cal. App. 588 at 592, the Court says:

"It is true that a deed which is absolute on its face, but which is intended merely to secure an indebtedness of the grantor, is a mortgage and does not actually convey title to the land. *(Moisant v. McPhee, supra.)* It is also true that a mortgage is merely a written contract hypothecating specific property and creating a lien for the security of a debt. (§2920, Civ. Code; 17 Cal. Jur. 696, §5) *Pacific Fruit Exchange v. Duke*, 103 Cal. App. 340 [284 Pac. 729].) A mortgage is not necessarily a grant of real property. (*Adler v. Sargent,* 109 Cal. 42, 49 [41 Pac. 799].)"

In *Moisant v. McPhee,* 92 Cal. 76 at 79, the Court says:

"At the trial, both Warren and appellant testified that the deed put in evidence was given only to secure the payment of an indebtedness on account. The deed was therefore a mortgage, and *did not pass the title to the land* which it purported to convey. (*Taylor v. McLain,* 64 Cal. 514; *Healy v. O'Brien,* 66 Cal. 519; *Raynor v. Drew,* 72 Cal. 309." (Emphasis ours.)

In *Anglo-Californian Bank v. Cerf,* 147 Cal. 384 at 388 to 389, the Court says:

"The fact that the defendant Steinhart, a manager of plaintiff corporation, was named as grantee in the deeds instead of the plaintiff itself, in no degree impairs their validity as mortgages in favor of plaintiff. If authority is needed upon this proposition it is to be found in *Banta v. Wise,* 135 Cal. 277 [67 Pac. 129], where the question was squarely presented in the case of a deed absolute on its face purporting to grant certain realty to one who was a member of a partnership. The deed was enforced as a mortgage in favor of the firm, it being shown that it was given as security for an indebtedness due the firm and to secure contemplated advancements by the firm. It was pointed out in the opinion that the general equitable principle applicable in this class of cases applies equally to all cases of deeds made to secure money, whether due or to become due, 'or whether *due to the grantee or another.*' It was said therein, speaking of a deed made to one as security for the debt of another: 'Such a transaction comes equally within the definition given in the code, which is, that a '"mortgage is a contract by which specific property is hypothecated for the performance of an act, without the necessity of a change of possession"' (Civ. Code, §2920), and also within the provision that '"Every transfer of an interest in property, other than in trust, made only as a security for another act, is to be deemed a mortgage,"' etc. (Civ. Code §2924.) The exception made in the section last cited refers only to the express trusts provided for by other provisions of the code (Secs. 852, 857) which, though in some cases difficult in principle to be distinguished, are

held not to be mortgages. . . . But these decisions apply only to cases where, by the terms of the deed, the trustee is authorized to sell and to apply the proceeds in payment of the debt, and not to deeds where there is no power of sale expressed."

See also:

33 Cal. Jur. 2d, p. 445, Par. 30.

"Since the deed to Lee was intended as a mortgage it transferred no interest in the land but created a lien only."

Lee, et al. v. U. S. Fire Ins. Co., et al., 55 Cal. App. 391.

Where Trust Deeds Are Given to Secure an Obligation the Trustor Is Treated as the Holder of the Legal Title.

The above question is covered in Paragraphs 86 to 91, 33 Cal. Jur. 2d, pages 490 to 496, and at page 492, it is said:

"The legal title is conveyed solely for the purpose of security, leaving in the trustor or his successor a legal estate in the property as against all persons except the trustee and those lawfully claiming under him. Otherwise, the trustor or his successor is treated in all respects as the holder of the legal title. The legal estate thus left in the trustor entitles him to possession of the property until his rights have been fully divested by a conveyance made by the trustee in the lawful execution of his trust, and to exercise all the ordinary incidents of ownership in regard to the property, subject always, of course, to the execution of the trust. In fact, the possessory rights of trustors are said to be the same as those of mortgagors."

The case of *King v. Gotz,* 70 Cal. 236, is cited in support of the above quotation from California Jurisprudence. This case incidentally also involves the validity of a homestead. The Court in this case says, at page 240:

> "The defendant Gotz, notwithstanding the execution of the trust deed, had an interest in the property which he could transfer or devise, subject only to the trust. (Civ. Code, §864.)
>
> And the grantee under him would acquire a legal estate in the property, except as against the trustees and those lawfully claiming under them. (Civ. Code, §865.)
>
> It follows from these provisions (which modify section 863 of the same code) that the trustor of an express trust, except as to his trustee and those holding under him, is treated as the holder of the legal title.
>
> The deeds of trust left an interest in Gotz which could have been sold under execution. (*Kennedy v. Nunan,* 52 Cal. 326.)"

and the case of *MacLeod v. Moran,* 153 Cal. 97 at 100, which also involves the validity of a homestead, says:

> "The nature of such an instrument has been extensively discussed by this court, and the sum and substance of such discussion is that while the legal title passes thereunder, and the trustees cannot be held to hold a mere 'lien' on the property, it is practically and substantially only a mortgage with power of sale. (See *Sacramento Bank v. Alcorn,* 121 Cal. 379 383, [53 Pac. 813]; *Tyler v. Currier,* 147 Cal. 31, 36, [81 Pac. 319]; *Weber v. McCleverty,* 149 Cal. 316, 320, [86 Pac. 706].) The legal title is conveyed solely for the purpose of security, leaving in the trustor or his successors a

> legal estate in the property, as against all persons except the trustees and those lawfully claiming under them. (Civ. Code, Secs. 865, 866.) Except as to the trustees and those holding under them, the trustor or his successor is treated by our law as the holder of the legal title. (*King v. Gotz,* 70 Cal. 236, [11 Pac. 656].) The legal estate thus left in the trustor or his successors entitles them to the possession of the property until their rights have been fully divested by a conveyance made by the trustees in the lawful execution of their trust, and entitles them to exercise all the ordinary incidents of ownership in regard to the property, subject always, of course, to the execution of the trust."

In *Bank of Italy v. Bentley,* 217 Cal. 644, Justice Shenk in commenting at length upon the legal status of the trustor's interest, beginning at ¶(7), p. 654 at p. 656, says:

> "The legal title is conveyed solely for the purpose of security, leaving in the trustor or his successor a legal estate in the property, as against all persons except the trustees and those lawfully claiming under them. (Civ. Code, Secs. 865, 866.) Except as to the trustees and those holding under them, the trustor or his successor is treated by our law as the holder of the legal title. (*King v. Gotz,* 70 Cal. 236 [11 Pac. 656].) The legal estate thus left in the trustor or his successors entitles them to the possession of the property until their rights have been fully divested by a conveyance made by the trustees in the lawful execution of their trust, and entitles them to exercise all the ordinary incidents of ownership in regard to the property, subject always, of course, to the execution of the trust."

In the case of *Hagge v. Drew,* 27 Cal. 2d 368 at 376, the Court says:

"It is urged that, assuming title was in defendants at the time of the contract of sale insofar as a conveyance by the owner was concerned, yet the finding of ownership in fee simple is against the evidence for the interest of defendants in the property was subject to the trust deed they had given to the trustee in bankruptcy; that a person who holds property on which there is a trust deed outstanding is not the owner in fee simple and that plaintiffs did not know of the trust deed when the contract of sale was made and were thereby defrauded. The evidence supports the conclusion that no representations were made by defendants or their agents in regard to the existence or lack of existence of a trust deed against the property, that is, nothing was said about the matter except to the extent that the statement in the contract, that defendants were the owners in fee simple, could be considered as such. There existed no fiduciary relation between plaintiffs and defendants. They were dealing at arm's length. For all practical purposes defendants may have been considered, as found by the court, to be the owners in fee simple of the property even though the trust deed was outstanding. 'Every estate of inheritance is a fee, and every such estate, when not defeasible or conditional, is a fee simple or an absolute fee." (Civ. Code, §762.) A fee simple title is one that is inheritable and the holder has the power to transfer. (See *In re Barlow v. Security T. & S. Bank,* 197 Cal. 263, [240 P. 19].) While it is true that in California the title theory is adhered to with respect to trust deeds and the lien theory with regard to mortgages, yet for practical purposes the

> trustor is the owner of the property. (See *Bank of Italy etc. Assn. v. Bentley,* 217 Cal. 644 [20 P. 2d 940].) In the instant case the defendants were the owners of the property having unrestricted power to dispose of it and to pass title to plaintiffs."

In *Estate of Moore,* 135 Cal. App. 2d 122 at 132, the Court says:

> "Though the trust deed has been analogized to a mortgage, especially between debtor and creditor, whenever necessary to avoid harshness in the application of the rule, it still remains true that title does not pass to the buyer but rests in the trustee for the primary benefit of the seller."

The court in *Wright v. Security-First Nat'l Bank,* 35 Cal. App. 2d 264, was considering a case in which the bank held a $60,000.00 mortgage. Also the owner of the land had entered into a trust whereby she had deeded 1100 acres of land in the San Bernardino mountains to A. J. Wheeler, subject to the mortgage. Wheeler owned adjoining land known as the Heath Ranch. In 1924 Mrs. Wright, Wheeler and James M. Oliver entered into an arrangement to combine the above land with other adjoining land for the purpose of developing a resort and land subdivision to be known as Wrightwood. To this end Wright and Wheeler conveyed their land to the bank under a trust agreement, the bank being named as trustee.

The court in this case in discussing the interest of the appellants, at page 272 says:

> "The first question naturally suggested is whether the interest of the appellants, as trustors, in the real property thus conveyed in trust was personal property or whether they retained an interest in real property which could only be divested as

such. While it is well settled that the grantor in an ordinary trust deed given to secure a debt retains an interest in the real property it is also well recognized that a different situation may exist where property is conveyed under certain trust provisions and for other purposes. It has been held that whether such trust property is to be considered as personalty or as an interest in real estate depends upon the intention of the parties and, in various cases, certain things have been held sufficient evidence of an intention to convert an interest in real property into one in personal property."

See also:

Lynch v. Cunningham, 131 Cal. App. 164;
Ogden's Calif. Real Property Law, p. 658.

Also attached in an Appendix No. 1 to this brief, is an extensive quotation from *Scott on Trusts,* Vol. 1, Sec. 9, pages 81-84.

See also appendix No. 2 which covers more in detail *White v. Stump* and *Myers v. Matley.*

"A debt is not a trust and there is not a fiduciary relation between debtor and creditor as such."
Downey v. Humphreys, 102 Cal. App. 2d 323 at 332.

It will be observed that among the cases cited herein in support of the contention that the trustor under a deed of trust retains legal title, are a number of cases involving the right of such a person to a homestead upon such property. It would therefore appear from the above that the bankrupt, at the time of bankruptcy, had something more than an equitable title. He held all of the incidents of title and was the legal owner. He could still hypothecate or sell or assign his interest therein. His interest was an interest upon which a judgment lien would attach.

Section 70a of the Bankruptcy Act, Vests the Trustee With Title to All Property in Said Section Described as of the Date of the Filing of the Petition in Bankruptcy, Upon Which an Exemption Had Not Then and There Been Perfected, if Certain Acts Are Required to Perfect the Exemption Claim.

Counsel argues that Section 70a of the Bankruptcy Act is not determinative of the time and manner of claiming such exemption.

I shall not attempt to answer in my own language this untenable contention of Appellee when the Supreme Court has so aptly spoken upon this subject. For the convenience of the Court, we again quote, in part, from *White v. Stump,* 266 U. S. 301, 45 S. Ct. 103, which is quoted from extensively in our opening brief at Pages 6, 7, 8 and 9. The language which we now quote is found on Pages 8 and 9 of our opening brief. It is:

> "The bankrupt's right to control and dispose of the estate terminates as of that time, save only as to 'property which is exempt.' Section 70a. The exception, as its words and the context show, is not of property which would or might be exempt if some condition not performed were performed, but of property to which there is under the state law a present right of exemption—one which withdraws the property from levy and sale under judicial process.
>
> 'The land in question here was not in that situation when the petition was filed. It was not then exempt under the state law, but was subject to levy and sale. One of the conditions on which it might have been rendered exempt had not been performed. Under the state law the fact that the other conditions were present did not suffice. The concurring presence of all was necessary to create a homestead exemption.' "

No court could make a plainer or more forceful statement of the law upon this point. It is still the law.

The case of *Myers v. Matley,* 318 U. S. 622, 63 S. Ct. 780, is only helpful or in point here under the State law of California and the facts of this case in two respects: That is, where the Court in the *Matley* case says:

> "If the law of Nevada respecting homestead exemptions were like that of Idaho, or operated in the same way, *White v. Stump* would be in point."

and, second, the Court in this case points out that the latest change in the phraseology of Section 70a of the Bankruptcy Act respecting exempt property, which says: ". . . except insofar as it is to property which is held to be exempt." does not alter the principles applicable to the exemption of homestead property in bankruptcy, and that the intent of Congress was merely to clarify the meaning of the Section. This should answer Appellee's contention on Page 2 of his brief.

Since the laws of Idaho and California are very similar, and the law of Nevada is entirely different, the rule the Court here would be required to follow is the reasoning of *White v. Stump.*

In 145 A. L. R., 503-504, it is said:

> "The doctrine of *White v. Stump* (US) supra, is recognized, and constitutes the starting point for discussion, in *Myers v. Matley* (US) (reported herewith) ante, 498.
>
> *White v. Stump* (1924), 266 U.S. 310, 69 L. Ed. 301, 45 S. Ct. 103, 5 Am. Bankr. Rep. (NS) 1, supra, overruled a decision of the Ninth Circuit which sustained a claim to a California homestead based on a declaration filed after bankruptcy. This was *Brandt v. Mayhew* (1914, CCA 9th) 218 F. 422, 33 Am. Bankr. Rep. 845. Under California

law declarations filed after levy are ineffective. *White v. Stump* (US) supra, therefore applies to render ineffective declarations filed in California after bankruptcy."

In this connection, Appellee cites the case of *Brandt v. Mayhew,* which as we have seen, has been overruled by the Supreme Court in *White v. Stump.*

The Trustee Stands in a More Favorable Position Than the Ordinary Lien Creditor of the Bankrupt to Attack the Validity of a Homestead.

The Trustee, by force of law, stands in the position of the most favored or ideal creditor under Sections 70a and 70c of the Bankruptcy Act, whether or not such a creditor actually exists. These sections are often referred to as the "strong-arm clause" and enables the Trustee to bring all of the bankrupt's property *not exempt at the time of the filing of the petition in bankruptcy* into the estate for the benefit of the creditors. See Vol. 4, *Collier on Bankruptcy,* 14th Ed., beginning at p. 926—also p. 943.

Section 70c of the Bankruptcy Act Now Expressly Fixes the Status of the Trustee in Bankruptcy as to the Bankrupt's Property as of "the Date of Bankruptcy".

Vol. 4, *Collier on Bankruptcy,* 14th Ed., p. 1424, says:

"It is *not* a prerequisite of the trustee's lien under § 70c that some actual creditor must have fastened a lien on the property at issue by legal or equitable process. A few courts construed former § 47a(2) . . . now the strong-arm clause of § 70c . . . so as to require the existence of an actual lien creditor as a condition of the trustee's lien. These cases were, however, overruled by the

> strong weight of better authority, and the Act of 1938 finally put to rest any conflict over the matter by specifically providing that the strong-arm clause should operate 'whether or not such a [lien] creditor actually exists.' This merely confirmed and ratified the prior decisions so holding. The amendments of 1950 and 1952 retained this explicit language. Accordingly, 'the trustee is, himself, in the position of a lien creditor as a matter of law. That is his legal status."

We have cited at page 6 of our opening brief certain sections of California's Civil Code which provide certain necessary steps to be taken in order to perfect a valid homestead. These sections require affirmative acts by the homesteader before the day of reckoning—the day of the filing of the petition in bankruptcy—the day that the estate of the bankrupt on property not then exempt vests in the Trustee in Bankruptcy by operation of law, and as so plainly stated by the Supreme Court in *White v. Stump.* [See above quotation.]

Status of Trustee as a Lien Creditor Under Section 70c of the Bankruptcy Act.

Vol. 4, *Collier on Bankruptcy*, 14th Ed., p. 1410, says:

> "It was said of the percursor of this provision that it conferred upon the trustee 'by force of law' the status of 'the ideal creditor, irreproachable and without notice, armed cap-a-pie with every right and power which is conferred by the law of the state upon its most favored creditor who has acquired a lien by legal or equitable proceedings.' If the description of the trustee's position under former § 70a was apt, it is even more so under the broader language of the amended § 70c."

Change in Law by 1950-1952 Amendments.

By virtue of the amendment of March 18, 1950 the trustee under § 70c now has all the rights, remedies and powers of a creditor holding a lien thereon obtained by legal or equitable proceedings, whether or not such a creditor actually exists. This section formerly read ". . . rights, remedies and powers of a judgment creditor holding an execution duly returned unsatisfied." The amendments of 1950 and 1952 made further changes. Each amendment was enacted to further strengthen and fortify the position of the Trustee. *Vol. 33, Collier on Bankruptcy,* 14th Ed., pages 1392 and 1396. The 1952 amendment came subsequent to the decision in *Sampsell v. Straub.*

There is thus no basis for continuing to ascribe to the Trustee the rights, remedies and powers of a particular lien creditor, since he is now vested, at the date of bankruptcy "with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

See:

Vol. 4, *Collier on Bankruptcy,* 14th Ed., pp. 1392, 1396, and 1493-94.

Courts have occasionally failed to note the change effected by the 1950 and 1952 amendments, hence our reference thereto.

See:

Jackson v. Minick (C. A. 9th, 1958), 260 F. 2d 563;

Mayo v. Petty (W.D.La. 1957), 153 F. Supp. 501.

Exceptions to Exemption of Homestead.

Section 1241 of the Civil Code of California provides:

"The homestead is subject to execution or forced sale in satisfaction of judgments obtained:

1. Before the declaration of homestead is recorded, and which, at the time of such recordation, constitute liens upon the premises.

2. On debts secured by mechanics, contractors, subcontractors, artisans, architects, builders, laborers of every class, materialmen's or vendors' liens upon the premises.

3. On debts secured by encumbrances on the premises executed and acknowledged by husband and wife, by a claimant of a married person's separate homestead, or by an unmarried claimant.

4. On debts secured by encumbrances on the premises, executed and recorded before the declaration of homestead was filed for record. [Enacted 1872; Am. Code Amdts. 1873-74, p. 229; Code Amdts. 1880, p. 7; Stats. 1887, p. 81; Stats. 1951, ch. 1109, §1; Stats. 1957, ch. 1317, §1; Stats. 1959, ch. 1805, §2.]"

The Trustee at the date of the filing of bankruptcy herein, under Section 70c of the Bankruptcy Act, stood in the position of each and all of the lien creditors mentioned in *Civil Code 1241,* with an enforceable lien since such a creditor of the bankrupt could have obtained such a lien by legal or equitable proceedings at the date of bankruptcy. Section 70c certainly includes any lien creditor of the bankrupt who could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, whether or not such creditor exists.

There are certain important comments upon the 1950-1952 changes in Section 70c of the Bankruptcy Act which appear in 1962 Collier Pamphlet Edition of the Bankruptcy Act.

Exemptions Under Sections 690.1 to 690.25, California Code of Civil Procedure, Are Exemptions Allowed as a Matter of Right and Do Not Require Affirmative Action on the Part of the Person Entitled Thereto Prior to the Making of His Claim.

While one in bankruptcy is required to make his claim to exemptions in his schedules (see Schedule B-5 as prescribed by the Supreme Court, as amended May 29, 1961, found in 1962 Collier, Pamphlet Edition of the Bankruptcy Act) and in certain circumstances schedules are filed after bankruptcy, the claim to the exemption must be considered as of the date of the filing of the petition in bankruptcy.

Whether the Rights of the Trustee in This Case Are Measured by the Provisions of Section 70a or 70c of the Bankruptcy Act, or Both, Still the Right of Homestead Exemption to the Bankrupt Should Be Denied.

We respectfully urge that the right of the bankrupt to a homestead was terminated as of the date of the filing of the petition in bankruptcy under Section 70a of the Bankruptcy Act and under the decision of *White v. Stump,* since the property in question was an asset of the bankruptcy estate as defined by Section 70a(5).

Under Section 70c, the Trustee stands in the position of the most favored creditor, for the benefit of all creditors, whether or not such creditor actually exists.

We have shown from California cases cited above, that one who gives a grant deed for the purpose of securing a loan is a mortgagor, and where one in connection therewith executes a trust with power of sale and retains possession and control of the property, is in the position of a person executing a deed of trust; that in

either event, such person does not part with, but retains legal title and therefore, a judgment lien would attach to such an interest.

Conclusion.

Since the Trustee is vested with the title of the bankrupt as of the date of bankruptcy under the provisions of Section 70a, and since he stands in the position of the most favored creditor under Section 70c of the Bankruptcy Act, we respectfully submit that the decision of the District Court should be reversed and that the claim of homestead exemption should be denied.

Respectfully submitted,

UTLEY & HOUCK,
By ERNEST R. UTLEY,
Attorneys for Trustee.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

Ernest R. Utley

APPENDIX 1.

Definitions and Distinctions.

§ 9. *Trust and mortgage or pledge or lien.* Although a mortgagee has an interest in property in which the mortgagor also has an interest, he is not trustee of the property for the mortgagor. In the early English law the common-law courts alone dealt with mortgages. A mortgage was created by a conveyance subject to a condition subsequent by which it was provided that if the debt secured thereby were paid when due, the interest of the mortgagee should cease and the property revert to the mortgagor. Under the earlier law, if the debt were paid when due, the legal title to the property reverted to the mortgagor, but if it were not paid when due, the title of the mortgagee became absolute and indefeasible. Subsequently the Court of Chancery gave relief against the forfeiture caused by the failure to pay the debt when due, and recognized in the mortgagor an equity of redemption. The Court of Chancery took the realistic attitude that the beneficial interest was in the mortgagor and that the mortgagee had merely a security interest. Even under this theory of the mortgage relation, where the mortgagee had the legal title to the mortgaged property and the mortgagor had the equitable beneficial interest in it, the mortgagee was not regarded as trustee for the mortgagor. In many states the courts, sometimes as a result of statutes, hold that the mortgagor not merely has an equitable interest but has legal title to the property subject to a legal security interest in the mortgagee. In such states the resemblance of a mortgage to a trust is even more remote than under the orthodox theory of the relation. Trust and mortgage serve different purposes, and

the consequences arising from the two relationships are different.

The interest of a mortgagee is a security interest. He holds this interest for his own benefit and not for the benefit of the mortgagor. A trustee, on the other hand, has an interest in the trust property which he holds for the beneficiaries, and not for his own benefit. A mortgagee cannot be compelled to surrender his interest in the mortgaged property until the debt secured by the mortgage is paid or otherwise discharged. A trustee has no such interest in the trust property as to permit him to prevent the termination of the trust, if there is no other reason for continuing the trust.[1] The trustee, however, has an interest in the trust property as security for his right to compensation and to indemnity for expenses properly incurred by him in the administration of the trust, and cannot be compelled to surrender the trust property on the termination of the trust until he is paid or secured for the amount thus due him.[2]

There is a fiduciary relation between trustee and beneficiary, but not ordinarily between mortgagee and mortgagor.[3] Thus, although it is a breach of

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[1]See § 337.

[2]See § 345.2.

[3]*England:* Dobson v. Land, 8 Hare 216 (1850); Taylor v. Russell, [1892] A.C. 244.
Alabama: Adler v. Van Kirk Land & Construction Co., 114 Ala. 551, 21 So. 490, 62 Am. St. Rep. 133 (1897).
California: De Martin v. Phelan, 115 Cal. 538, 47 Pac. 356, 56 Am. St. Rep. 115 (1897).
Illinois: Guffey v. Washburn, 382 Ill. 376, 46 N.E.(2d) 971 (1943).
Massachusetts: Dennett v. Tilton, 227 Mass. 299, 116 N.E. 403 (1917).
Oklahoma: Crockett v. Root, 194 Okla. 3, 146 P.(2d) 555

trust for a trustee to transfer the trust property to a third person, a mortgagee can properly transfer his interest in the debt and in the security. Although a trustee is under a duty not to delegate the trust, there is no similar personal relationship between mortgagee and mortgagor which prevents the mortgagee from transferring his interest. In *Taylor v. Russell,*[4] Lord Herschell said: "No authority was cited for the proposition that a mortgagee is, subject to his security, a trustee of the legal estate for the mortgagor. The rights of a mortgagor are no doubt well established in a Court of Equity. He may redeem the mortgage, and no dealings with the property by the mortgagee, save a conveyance under the power of sale, can deprive him of this right. But it is quite a different proposition and one which I think is wholly untenable to assert that a mortgagee is trustee for the mortgagor. It is admitted that a mortgagee may create such estates as he pleases, he may convey, by way of sub-mortgage, to whom and in as many parcels as he pleases."

Similarly, although a trustee is not permitted to profit by purchasing an encumbrance upon the trust property,[5] a mortgagee is not under a like disability in

(1944) (citing Restatement of Trusts, § 9, Comment *c*), noted in 15 Okla. B.A.J. 432.

Oregon: See Harper v. Interstate Brewery Co., 168 Ore. 26, 120 P.(2d) 757 (1942) (citing the text).

Rhode Island: Koury v. Sood, 74 R.I. 486, 62 A.(2d) 649 (1948) (citing the text).

Courts of equity, however, go far in protecting the mortgagor from losing his equity of redemption, particularly where the mortgagee has a power of sale. Cambridge Savings Bank v. Cronin, 289 Mass. 379, 382, 194 N.E. 289 (1935). This matter is beyond the scope of this treatise.

[4][1892] A.C. 244, 255.

[5]See § 170.21.

purchasing prior mortgages. In *Dobson v. Land*[6] the court said: "Now, that a mortgagee is in some sense a trustee for the mortgagor, may be admitted; for every person in whom the legal estate is vested, with a beneficial interest for another person, in a sense, is a trustee for that person . . . a trustee can never make a benefit to himself by any dealing with the trust property; but if a second mortgagee should buy in the first mortgage for half its amount, or even obtain an assignment without consideration from the first mortgagee, I can have no doubt he would be entitled to charge the mortgagor with the full amount of the first mortgage in addition to his own."

Although a pledge has sometimes been spoken of as in the nature of a trust,[7] it is not a trust and has not the legal consequences of a trust. The pledgee does not owe to the pledgor the fiduciary duties owing by trustee to beneficiary. Thus it was held in *Willett v. Herrick*[8] that a purchase by the pledgee from the pledgor of the subject matter of the pledge cannot be set aside on the ground that the pledgee did not make full disclosure to the pledgor. In that case the court said: "As pledgees they were required to use good faith in dealing with the property pledged or in conducting a sale, but this did not impose on them the additional duties of a fiduciary in matters unrelated to the pledge. A pledge is not a trust and the defendants were not trustees in the true sense of the term. . . . Even if the contract were a mortgage, the relation of mortgagor and mortgagee is not of a fiduciary character."

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[6]Hare 216, 220 (1850).

[7]Newton v. Fay, 10 Allen 505, 507 (Mass. 1865); Dibert v. D'Arcy, 248 Mo. 617, 154 S.W. 1116 (1912).

[8]258 Mass. 585, 599, 155 N.E. 589 (1927).

Although the debt which is secured by a pledge is paid off without a return of the property to the pledgor, the pledgee does not become trustee for the pledgor. He might perhaps be called a constructive trustee, but the fiduciary element inherent in the express trust is lacking.[9] Accordingly, it has been held that if the pledgor makes no attempt to compel the return of the property for a long period after the payment of the debt, the pledgor is barred from maintaining an action against the pledgee for the return of the property,[10] although it is well settled that under similar circumstances the beneficiary of a trust would not be precluded from maintaining a suit against the trustee.[11]

There may, of course, be a combination of the two relationships; a mortgage may be held in trust. If a trustee of money lends it and takes a mortgage to secure the loan, he is trustee of the mortgage for the beneficiary of the trust, but he is not trustee for the debtor and there is no fiduciary relation between him and the debtor.[12] On the other hand, a mortgage may be made

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[9]Carpenter & Carpenter, Inc. v. Kingham, 56 Wyo. 314, 109 P.(2d) 463, 110 P.(2d) 824 (1941).

[10]Wehrle v. Mercantile National Bank of Salem, 221 Mass. 585, 109 N.E. 367 (1915); Kase v. Burnham, 206 Pa. 330, 55 Atl. 1028 (1903); Sulkin v. First National Bank & Trust Co., 344 Pa. 251, 25 A.(2d) 166, 139 A.L.R. 1331 (1942); Reynolds v. Hennessy, 15 R.I. 215, 2 Atl. 701 (1886).

But see Stebbins v. Clendenin, 136 Ark. 391, 206 S.W. 681 (1918) (absolute deed as mortgage); Green v. Turner, 38 Iowa 112 (1874) (mortgage).

As to the distinction between a trust and a pledge, see also Colantuoni v. Balene, 95 N.J. Eq. 748, 123 Atl. 541 (1924); State v. Channer, 115 Ohio St. 350, 154 N.E. 728 (1926) (pledgee not guilty of embezzlement).

See note, Pledge as a trust as regards statute of limitations, 139 A.L.R. 1333 (1942).

[11]See §§ 219-219.4.

[12]Dennett v. Tilton, 227 Mass. 299, 116 N.E. 403 (1917); Bradford v. King, 18 R.I. 743, 31 Atl. 166 (1894).

to a person as trustee both for the creditor and for the debtor. Thus a trustee under a deed of trust in the nature of a mortgage is a trustee for and in a fiduciary relation to both the creditor and the debtor.[13] A distinction has been taken between the situation in which property is transferred to a trustee to secure a debt of the transferor to a third person where there is a mortgage in trust and the transferor has an equity of redemption, and the situation in which property is transferred to a trustee to use the property or its proceeds to pay debts of the transferor where the transaction is not a security transaction and the transferor has no equity of redemption, although he is entitled to enforce a resulting trust of any surplus which may remain after the payment of the debts.[14]

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[13]*District of Columbia:* W. A. H. Church, Inc. v. Holmes, 60 App. D.C. 27, 46 F.(2d) 608 (1931); Holman v. Ryon, 61 App. D.C. 10, 56 F.(2d) 307 (1932).

Illinois: White v. Macqueen, 360 Ill. 236, 244, 195 N.E. 832, 98 A.L.R. 1115 (1935).

North Carolina: Hinton v. Pritchard, 120 N.C. 1, 26 S.E. 627, 58 Am. St. Rep. 768 (1897).

Wisconsin: Schroeder v. Arcade Theater Co., 175 Wis. 79, 106, 184 N.W. 542 (1921).

See Posner, Liability of the Trustee under the Corporate Indenture, 42 Harv. L. Rev. 198 (1928).

Where a lender pays money to a trust company to be paid to the borrower on the execution of a mortgage by him, the trust company, if it holds the money in trust, is trustee for both the lender and the borrower. See Civic Building & Loan Association's Appeal, 121 Pa. Super. 597, 184 Atl. 311 (1936).

[14]Hoffman, Burneston & Co. v. Mackall, 5 Ohio St. 124, 130-131 (1855).

See also Vance v. Lincoln, 38 Cal. 586 (1869); Neikirk v. Boulder Bank, 53 Colo. 350, 127 Pac. 137 (1912); McDonald v. Kellogg, 30 Kan. 170, 2 Pac. 507 (1883); Lance's Appeal, 112 Pa. 456, 4 Atl. 375 (1886); Catlett v. Starr, 70 Tex. 485, 7 S.W. 844 (1888).

APPENDIX 2.

The Appellee's Brief states:

"1. Section 70a of the Bankruptcy Act vests the trustee with title only to bankrupt's non-exempt property, and is not determinative of the time and manner of claiming such exemptions."

Section 70a of the Bankruptcy Act, which vests the trustee by operation of law with the title of the bankrupt as of the date of the filing of the petition, qualifies this vesting as follows: *"Except insofar as it is to property which is held to be exempt."*

The case of *White v. Stump,* 266 U.S. 310, 45 S.Ct. 103, is the controlling authority with respect to bankruptcy proceedings in the State of California. The decision involved a contended homestead exemption in the state of Idaho which has a similar law. In this Idaho case, no declaration was filed for record until after the filing of the bankruptcy. The district court, in the first instance, in reliance upon the case of *Brandt v. Mayhew,* 218 F.2d 422 (decided in 1914), held that the bankrupt was not precluded from claiming a homestead in California as exempt merely because, when the petition in bankruptcy was filed, he had not done all that is required by the state law to entitle him to the exemption, and further, that he may rightfully demand that the exemption be allowed where he has met the requirements of the state law within a reasonable time after the filing of the bankruptcy petition. The Circuit Court of Appeals for the 9th Circuit adhered to that decision and sustained the order of the district court. The Brandt case was of course relied heavily upon as the authority also for the same result in the state of Idaho with its similar exemption law.

However, the Supreme Court, in reversing the effect of the *Brandt v. Mayhew* case, said, in part, that the pertinent provisions of the bankruptcy law "show that the point of time which is to separate the old situation from the new in a bankrupt's affairs is the date when the petition is filed—Thus we have said that the law discloses a purpose 'intent' to fix the time of cleaveage, with special regard to the conditions existing when the petition is filed—It was not then exempt under the state law but was subject to levy and sale."

The appellee's brief makes the following comment on the *Brandt v. Mayhew* case (1914): "This is not the meaning of Section 70a. That section applies only to non-exempt property and does not deal with the time or manner of claiming exemption.

The *White v. Stump* case was further fortified by the United States Supreme Court in its case of *Myers v. Matley* decided in 1943. The exemption involved in this case was a selection of a homestead by a bankrupt in Nevada. The court had occasion to comment on the then new phraseology in the amendment of Section 70a (The Amendment changed the phrase "Insofar as it is not exempt" to "Except insofar as it is the property which is held to be exempt.") and states on page 625: "We conclude that the new phraseology in the amendment of Section 70a does not alter the principles applicable to the exemption of homestead property in bankruptcy."

In discussing the court's prior decision of *White v. Stump,* the court states, on page 625:

> "White v. Stump—involved the homestead exemption claimed pursuant to the law of Idaho under which the declaration of homestead was required

to be executed and acknowledged like a conveyance of real property and filed for record. The exemption arose when the declaration was filed and not before. Up to that time the land remained subject to execution and attachment like any other land; and where a levy was effected while the land was in that condition, the subsequent making and filing of a declaration neither avoided the levy nor prevented a sale under it."

(Note: An exception is noted here as between the Idaho and California law, in that in California an attachment does not bar the recording of a declaration of homestead.)

"This Court held that the Bankruptcy Act fixed the point of time which is to separate the old situation from the new in the bankrupt's affairs as the date when the petition is filed. *If the law of Nevada respecting homestead exemptions were like that of Idaho, or operated in the same way, White v. Stump would be in point.*"

Section 3315 of the Compiled Laws of Nevada define property which may be claimed as exempt as a homestead and permits selection by either the husband or the wife or both, by a declaration of intention in writing to claim the same.—"

"Section 8844 provides that the following property is exempt—etc."

Further from the opinion of Myers v. Matley, page 627:

"Historically, and under the theory of the present act, bankruptcy *has the force and effect of the levy of an execution* for the benefit of creditors to in-

> sure an equitable distribution among them of the bankrupt's assets. The trustee is vested not only with the title of the bankrupt but clothed with *the right of an execution creditor with a levy on the property which passes into the trustee's possession.*"

In this instance, the court was commenting upon Section 70c of the Bankruptcy Act which is the so-called strong arm provision of the Bankruptcy Act, which provides that "the trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall deem vested as of such date with all the rights, remedies and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

This situation is, of course, hypothetical. The trustee can select a superior lien, in some instances an attachment lien, hypothetically selected, will suffice. In some, a recorded judgment lien will suffice and in an instance when a recorded judgment lien will not suffice, then, of course, an execution lien may be hypothetically selected. In fact, this is envisioned and expressly set forth in the *Myers v. Matley* case with the quotation above referred to: "The trustee is vested not only with the title of the bankrupt but clothed with the right of an execution creditor *with a levy on the property.*"

In California, an execution levied upon real property creates a lien thereon, cutting off all subsequent rights, claims, contentions, exemptions, etc. Civil Code Section 1241 states:

> "The homestead is subject to execution or forced sale in satisfaction of judgments obtained:

1) before the declaration of homestead was filed for record which constitute liens upon the premises."

Thus the trustee's lien by levy of the execution as referred to in the *Myers v. Matley* case would effectively block the declaration of homestead which was recorded subsequent to the date of bankruptcy at which time the trustee inherited the said rights to title and rights of lien.

In concluding the analysis of the Nevada law with respect to selection of homestead, the *Myers v. Matley* decision concludes, on page 627, that

"Examination of the Nevada cases relied on by the court below satisfied us that the settled law of the state entitles the debtor to his homestead exemption if the selection and recording occurs at any time before actual sale under execution.—In conformity with the principles announced in White v. Stump that the bankrupt's right to a homestead exemption becomes fixed at the date of the filing of the petition in bankruptcy and cannot thereafter be enlarged or altered by anything the bankrupt may do, it still remains true that, under the laws of Nevada, the right to make and record the necessary declaration of homestead existed in the bankrupt at the date of filing the petition as it would have existed in case a levy had been made upon the property. The assertion of that right before actual sale in accordance with state law did not change the relative status of the claimant and the trustee subsequent to the filing of the petition. The Federal Courts have generally so held and have distinguished White v Stump when the state law was

> similar in terms or in effect to that of Nevada." Citing Re *Rammmell,* 5 F.2d 326; *Clark v. Nirenbaum,* 8 F.2d 451; *McRae v. Felder,* 12 F.2d 554 and with a contra decision, *Georgouses v. Gillen,* 24 F.2d 292.

This latter case of the 9th Circuit determined that under Arizona law a homestead could not be selected after the filing of the bankruptcy proceedings. It cited as the authority therefor *White v. Stump,* 266 U.S. 310.

The second point set forth in the brief of the appellee is the following, to wit: IN ORDER TO ASCERTAIN WHETHER PROPERTY IS EXEMPT, ANALYSIS MUST BE MADE OF THE APPLICABLE STATE LAWS DEALING WITH EXEMPTIONS.

Under this point there is the appelle's comment on the case of *White v. Stump* with this observation:

> "Under the then existing law in Idaho, in the absence of bankruptcy, any creditor who had levied upon an attachment or execution would prevail over a subsequently filed homestead."

and dismissed the case entirely with the further statement:

> "Hence, in that case, since the bankrupt's creditors could have reached the land by levy and sale, the court held the property not to be exempt."

The bankrupt and his wife had title to the home and they caused the same to be placed in the name of the Title Insurance and Trust Company under a form of "trust" to secure money loaned by it to them, erroneously assumes that under Section 70c of the Bank-

ruptcy Act, sufficient and adequate liens by legal or equitable proceedings were not vested in the trustee which would reach his beneficial interest in the trust.

This error comes about through his point No. 3 which we will discuss hereinafter. The quotation from the *Myers v. Matley* case set forth on page 5 of Appellee's Brief adds considerably to the contention as asserted herein with the accentuation by the appellee of the following:

> "The trustee is vested not only with the title of the bankrupt, but clothed with right of an *execution creditor with a levy on the property which passes into the trustee's custody.*"

There is the further comment on page 5 under this same point of Appellee's Brief:

> "If that lien creditor has no rights under the state law, then neither does the trustee as to the property in question, and the property as exempt."

In the case of *Sampsell v. Straub*, 194 F. 2d 228, 9th Circuit, 1952 it is difficult for us to see how in any manner or by any means reference to the *Sampsell v. Straub* case can assist or fortify the contentions of the appellee. In supporting the contention that the rights of the trustee, the decision, on page 230, states:

> "On the other hand, the lien obtained by recording an abstract of judgment is described as a judgment lien. The California statute provides that a 'judgment or decree becomes a lien upon the filing of the abstract.' Code of Civil Procedure 674. And while recording is an independent step in the sense of being something voluntary beyond the entry of the judgment, it is incidental to the ju-

dicial process in the sense of a device to give a judgment particular effect. The judgment is the basic and fundamental source of right whether generally before recordation or by way of lien after recordation. —The context of Section 3, sub. a(3) and Section 67(a) rather clearly indicates that the California judgment lien should be regarded as a lien obtained by 'legal proceedings' within the meaning of these sections.

And the same includes 'a California judgment lien' among liens obtained by legal proceedings even though voluntary recordation is the essential final step in its creation—therefore, the assertion of this status of California judgment lienor by the trustee would be consistent with, though not essential, to the primary objection of Section 70(c). In brief, the policy of Section 70(c) permits the inclusive conception of liens by legal proceedings which the policy of Section 3a(3) and 67(a) require."

The final portion of the opinion on page 232 recites:

"That a California judgment lien though perfected only by voluntary recordation is a lien by legal or equitable proceedings within the meaning of Section 70(c).

Accordingly, we now vacate our order affirming the judgment of the district court and reverse the judgment."

Thus, the status of the trustee under Section 70(c) with the right of a recorded judgment lien was established. As we have noted hereinabove, the Supreme Court has gone one step further in the hypothetical legal proceedings and has equipped the trustee with an execution lien.

The third point as set forth in Appellee's Brief states: APPELLEE'S DECLARATION OF HOMESTEAD WHICH, IN THE ABSENCE OF BANKRUPTCY, WOULD HAVE PREVAILED IN CALIFORNIA AGAINST ANY LIEN CREDITOR AT THE TIME OF ITS FILING, WILL PREVAIL AGAINST THE TRUSTEE.

This statement is very seriously disputed. One would assume from this statement that in California it is impossible for creditors by legal proceedings to reach the beneficial interest of a trustee in real property and that is not the law. If we even assume that the conclusion is correct as to the particular feature of the California law (Code of Civil Procedure Section 674) with respect to the recording of an abstract of judgment where the judgment debtor has merely equitable title does not create a lien on the equitable interest by recordation of the abstract of judgment. The legal process, however, as against owners of beneficial interest in real property does not stop here. If so, this would create an absolute void.

The question is then, how in California does a creditor, by legal or equitable proceedings, with a recorded judgment against the defendant, reach the beneficial interest of the defendant in a real property trust.

The levy of an execution on real property creates a lien thereon and thus covers the beneficial interest of the defendant beneficiary. Thus it is not necessary to answer the various cases cited supporting the California law that the recording of an abstract of judgment does not create a lien upon real property held in trust for the defendant beneficiary, inasmuch as Code of Civil Procedure 674 does not specifically provide therefor.

We admit either the bankrupt or his wife could have filed a declaration of homestead on their home property which they were occupying, both before they transferred the same as well as after they transferred the same to the Title Insurance and Trust Company to hold in trust for them as a security for the loan which the Title Company made to the Chohons.

The case of *Poindexter v. Los Angeles Stone Co.,* 60 Cal. App. 686, holds that the recorded abstract of a judgment creates the lien only on legal interest in real property and does not create a lien created against the lien of a cestui que trust. This case however gives the answer to the query asserted by us hereinabove as to just how the interest can be reached and it states, on page 688 of the opinion:

> "It is true that execution may be levied against equitable as well as legal interest in real property—thus because the statute relating to execution expressly provides that a sale may be made of both real and personal property 'or any interest therein not exempt by law.' "

The case refers to a prior California case of *Belieu v. Power,* 54 Cal. App. 244 (1921) which determined that the judgment lien does not attach to the equitable interest of the defendant in real property. In commenting on Section 671 of the Code of Civil Procedure, page 246 states:

> "Property interests of every kind, whether real or personal, and every interest therein are subject to seizure under attachment or *levy on execution* unless exempt from execution (Section 542 and 688, Code of Civil Procedure). While many classes of property may be taken on execution, only two

classes are subject to the lien of a judgment—real property owned by the debtor at the time of docketing and real property that he may afterwards acquire. While any interest in real property, legal or equitable, may be seized and sold under execution, only real property actually owned by the judgment debtor will support a judgment lien."

The trustee, by the provisions of Section 70(c) acquires the rights of an execution lien and thus the homestead declaration must be recorded *to be effective* before the advent of bankruptcy.